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IN THE

Supreme Court of the United States

October Term, 1950.

No. 478

MINE HILL & SCHUYLKILL HAVEN RAILROAD COMPANY,

Petitioner,

v.

FRANCIS R. SMITH, Collector of Internal Revenue,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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Mine Hill & Schuylkill Haven Railroad Company prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit, entered in the above-entitled case on October 4, 1950.

OPINIONS BELOW.

The opinion of the District Court (R. 24a) is reported in 88 F. Supp. 803. The opinion of the Court of Appeals (R. 32) is reported in 184 F. 2d 422.

JURISDICTION.

The judgments of the Court of Appeals were entered on October 4, 1950 (R. 39, 40). The jurisdiction of this Court is invoked under 28 USC, Section 1254 (1).

QUESTION PRESENTED.

In what year is the lessor of railroad property subject to the Interstate Commerce Act entitled to claim a loss for income tax purposes by reason of the lessee's abandonment of such property?

More specifically stated the question is:

Whether, where railroad lines have been leased prior to the amendment of the Interstate Commerce Act by the Transportation Act of 1920 under a long-term lease containing a covenant by the lessee to return the demised property in good order and condition at the termination of the lease, the lessor is entitled, for income tax purposes, to deduct in the year in which an abandonment takes place in accordance with the authorization of the Interstate Commerce Commission a loss on account of an abandonment made in the manner permitted by the lease, or must deduct it in some prior year when the lessee ceased to maintain and operate the abandoned property.

STATUTES INVOLVED.

The pertinent statutory provisions are printed in Appendix A, infra, p. 9.

STATEMENT.

Petitioner is a Pennsylvania corporation and is the owner of certain railroad lines in eastern Pennsylvania, all of which are leased to and operated by the Reading Company as lessee under a nine-hundred ninety-nine year lease dated December 31, 1896 (R. 3a). The lease requires the lessee to keep the leased premises in good order and repair and at the termination of the lease to surrender them in the same good order and condition as they were at the beginning of the lease except that lessee is not required under certain conditions to maintain in such good order and repair branch lines (R. 6a, 7a). The lines here in question fell within these exceptions.

On November 10, 1941, an application was filed by petitioner and the lessee with the Interstate Commerce Commission for permission to abandon certain branch lines covered by the lease (R. 4a). On February 16, 1942, the Interstate Commerce Commission issued a Certificate of Public Convenience and Necessity authorizing petitioner and lessee to abandon these lines and the operation thereof, and thereupon they were so abandoned (R. 5a). Petitioner's investment in said branch lines amounted to $104,985.48. Salvage amounted to $9,907.43. Petitioner claims the difference, or $95,078.05, as a deduction in computing its income tax liability for the calendar year 1942 (R. 3a).

On October 4, 1943, an application was filed by Petitioner and the lessee with the Interstate Commerce Commission for permission to abandon additional branch lines covered by the lease (R. 16a). On October 22, 1943, the Interstate Commerce Commission issued a Certificate of Public Convenience and Necessity authorizing petitioner and lessee to abandon these lines and the operation thereof and thereupon they were so abandoned (R. 17a). Petitioner's investment in said branch lines amounted to $70,324.28. Salvage amounted to $2,264.06. Petitioner claims the difference, or $68,060.22 as a deduction in computing its income tax liability for the calendar year 1943 (R. 15a).

For several years prior to 1942 the lessee had not operated or maintained the branch lines here in question.

Petitioner and lessee are subject to the Interstate Commerce Act.

The Commissioner of Internal Revenue disallowed the losses claimed on the ground that they were not sustained in the years 1942 and 1943 and assessed deficiency taxes which were paid by petitioner to respondent on December 7, 1945. Upon disallowance of petitioner's claims for refund, suits were brought in the United States District Court for the Eastern District of Pennsylvania and consolidated.

The District Court held that petitioner was not entitled to deduct its abandonment losses in the years 1942 and 1943 (R. 28a). It held that the lessee had abandoned the lines prior to those years (R. 27a) and that the lessee's obligation to petitioner was extinguished prior to the years 1942 and 1943, the years in which the Interstate Commerce Commission had consented to the abandonments (R. 27a).

The Court below affirmed the judgments of the District Court on the grounds that an "appellate court is *limited* to a consideration whether the fact-finding was 'clearly erroneous' and the decision of the trial court was 'in accordance with law'" (R. 37). The Court held that "there need not be a coincidence of intention of abandonment with the act of abandonment and that the act alone is sufficient" (R. 38) and that "the requirements of the Interstate Commerce Act are not determinative of liability under the Revenue Act" (R. 38).

SPECIFICATION OF ERRORS TO BE URGED.

The Court of Appeals erred:

1. In holding that where a railroad lease requires the return to lessor at the end of the lease of leased property not abandoned by lessee, an abandonment loss for income tax purposes can be claimed by the lessor prior to the year in which the consent of the Interstate Commerce Commission to such abandonment is obtained as required by the Transportation Act of 1920.

2. In holding that for income tax purposes a loss by reason of abandonment can be claimed where there is no intention to abandon but only failure to maintain and use.

3. In affirming the judgments of the District Court.

REASONS FOR GRANTING THE WRIT.

The reasons we believe certiorari should be granted are:

1. The Primary Question Here Is One Which Has Not Been Presented to This Court Before, Though It Is a Matter of Very Great Importance to All Lessor Railroad Companies.

There are hundreds of lessor railroad companies having millions of dollars of capital invested in railroad lines and facilities which are leased under long-term leases to operating railroad companies. The use of such leases was one of the means by which the railroad systems of this country were assembled. The properties of these lessor companies have been leased for many years during which time the lessor companies have usually received fixed rentals. Due to the gradual increase in taxes, and particularly the substantial increase in the United States income tax in recent years, the net income of most of these lessor companies has decreased considerably. It will readily be recognized that the prospects of a change in this trend are exceedingly dim. Times and conditions have changed since these leases were entered into and, as a consequence, branch lines and facilities which once were valuable now have little value and, consequently, are being abandoned. If abandonments continue, it is not unlikely that many of the lessor companies in the not too distant future will find that their capital is impaired. A financially sound system of railroads is of the utmost importance to the national welfare and the security of the nation. If the decision of the Court below is allowed to stand, many lessor companies will never be able to obtain the benefit of deductions for abandonment losses in computing their income tax liability because they learn of abandonments only when applications are made to the Interstate Commerce Commission. Under the decision of the lower Court, it is then too late. If the simple non-user of lines and facilities is in itself to constitute abandonment or, if the intent to

abandon is to be inferred from the mere fact of non-use and failure to maintain, then, unless the lessor companies go back into business and employ trackwalkers, inspectors and others, they will be unable to learn of such failure to use and maintain in time to secure the deduction for losses to which they justly are entitled. Furthermore, there seems to be no justification for insisting on this mode of procedure as the lessor company usually, as in the case at bar, has the covenant of the lessee to surrender the property at the termination of the lease in the same good order and condition as it was at the beginning. Until the lessee has been discharged of this obligation, how can it be said that the lessor has suffered any loss and how can the lessee be relieved of this obligation without first securing the consent of the Interstate Commerce Commission? The questions are of great importance, not only to petitioner, but to many other lessor companies owning railroad properties situated all over the United States.

2. The Decision of the Court Below Conflicts in Principle With Decisions of This Court.

The lower Court held that the Transportation Act of 1920 did not affect the rights of the parties to the lease as between themselves (R. 27a). This is in conflict with the rule laid down in the case of *Thompson v. Texas Mexican Ry. Co.*, 328 U. S. 134 (1946), in which this Court held (p. 146) that the Interstate Commerce Commission has jurisdiction under the Transportation Act of 1940 to determine the terms and conditions under which trackage rights may be enjoyed.

It is submitted that the instant case is not controlled by *Boehm v. Commissioner*, 326 U. S. 287 (1945), which held that the worthlessness of stock can be established entirely by objective tests. The instant case involves an abandonment which requires both an act of abandonment and an intent to abandon and, therefore, both the sub-

jective and objective tests must be used in determining the year in which the deduction is allowable. Nor is it controlled by *Old Colony Railroad Co. v. Commissioner*, 284 U. S. 552 (1932), which held that rules of accounting of the Interstate Commerce Commission are not binding upon the Commissioner of Internal Revenue (562).

CONCLUSION.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

MORSE GARWOOD,
HAROLD EVANS,
Counsel for Petitioner.

MACCOY, EVANS & LEWIS,
Of Counsel.

December 28, 1950.

APPENDIX A.

Internal Revenue Code.

Section 23. **Deductions from Gross Income.**

In computing net income there shall be allowed as deductions:

(f) **Losses by Corporations.**—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

Section 23 (f), 53 Stat. 12 (1939), 26 U. S. C. A. Section 23 (f).

Interstate Commerce Act.

Section 1.(18) * * * and no carrier by railroad subject to this chapter shall abandon all or any portion of a line of railroad, or the operation thereof, unless and until there shall first have been obtained from the commission a certificate that the present or future public convenience and necessity permit of such abandonment. * * * [Added by the Transportation Act of 1920 (41 Stat. 477 (1920) 49 U. S. C. A. § 1 (18) (1949 Supp.)]